Fee-shifting Offers of Judgment–An Approach to Reducing the Cost of Litigation

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Fee-shifting offers of judgment—an approach to reducing the cost of litigation

While the English loser-pays rule is a flawed approach to reducing the cost of litigation in the United States, the English payment-into-court rule offers a model for limited fee shifting to encourage early settlement. This process can operate through amendment of Rule 68 of the Federal Rules of Civil Procedure.

by William W Schwarzer

After fighting since 1988 over "The Uncollected Stories of John Cheever," the publishing firm Academy Chicago and the late writer's family reached a settlement this week .... The Cheevers have now agreed to drop a lawsuit they had filed in New York. In exchange, Academy Chicago said it would not publish any out-of-copyright material by the celebrated writer ....

The Cheevers, whose legal fees were estimated at more than twice the $420,000 Academy paid, could not be reached for comment. Their lawyer... said yesterday: "They are elated."

Elated?

"They're elated it's over," he amended.

But is "elated" really the word he wanted to use?

"I think 'relieved' is more accurate," he agreed.[1]

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1. Streitfeld, *Cheevers, Publisher End Fight*, WASHINGTON POST, January 25, 1992, at C5.

2. Hensler *et al.*, TRENDS IN TORT LITIGATION: THE STORY BEHIND THE STATISTICS 27 (1987), as cited in Saks, *Do We Really Know Anything About the Behavior of the Tort Litigation System—and Why Not*, 140 U. PENN. L. REV. 1147, 1282 (1992) (statistic based on non-auto torts).

3. Drawing on data from Kakalik & Pace, COSTS AND COMPENSATION PAID IN TORT LITIGATION vi, 67-68, 75 (1986) and Sturgis, "The Cost of the U.S. Tort System: An Address to the American Insurance Association" (1985), cited in Saks, *supra* n. 2, at 1281-1283.

Is it possible to reduce the cost of litigation by creating incentives to settle quickly? Virtually nobody disputes that costs have skyrocketed and are often disproportionate to the stakes. One recent study reported that it costs $2.33 to deliver $1 in compensation to tort victims.[2] The total cost of tort litigation alone in 1985 has been estimated as high as $29-36 billion, only $14-16 billion of which went to compensate victims.[3]

Some argue that the cost of litigation could be reduced by adopting the English "loser pays" rule. Advocates of the rule maintain that it would not only restrain frivolous or marginal litigation, but would also more fully compensate the prevailing party. Yet a closer look at the rule reveals that, at least on this side of the Atlantic, it would be counterproductive. It would tend to deter meritorious as well as frivolous claims and defenses, fail to distinguish between the real winners and losers, and produce windfalls as well as draconian penalties.

English practice does, however, offer an alternative approach of greater promise—the "payment into court" rule under which a defendant may deposit in court a sum in satisfaction of the plaintiff's claim. If the plaintiff does not accept it, goes to trial, and recovers less than the sum offered, it is not entitled to recover costs and instead must pay the defendant's costs (which in England include reasonable attorney fees as determined by a taxing master) from the time of the payment into court.

Our own Rule 68 of the Federal Rules of Civil Procedure is a cousin of the English practice. But Rule 68 has never had a significant impact, largely because it is limited to court costs. The utility of the English practice of payment into court (coupled with growing interest in the United States in experimenting with fee shifting) suggests that revision of Rule 68 to encourage early settlement without inflicting draconian penalties or generating windfalls deserves renewed and serious consideration.

Twice before, in 1983 and 1984, the Advisory Committee on Civil Rules considered amendments of Rule 68 to include attorney fees, but both attempts met with vigorous opposition and failed. The principal objections were that fee-shifting offers of judgment could have a devastating impact on plaintiffs (including those with meritorious claims), and that they could circumvent the statutory provisions for attorney fees in civil rights cases, undermining important policies underlying the civil rights laws.

The revision proposed in this article meets these objections. It would permit plaintiffs as well as defendants to make offers of judgment. If the offeree fails after a trial to improve his or her position over what it would have been had the offer been accepted, the offeror is entitled to post-offer costs (including reasonable attorney fees). But the amount of costs that could be recovered under the rule would always be limited to the lesser of the following: the amount of the judgment, or the amount needed to make the offeror whole for having had to go to trial. Claims subject to statutory fee shifting and class and derivative actions would be exempted.

This article first analyzes the operation of the English loser-pays and payment-into-court rules as background for the proposed revision. It then describes how the proposed amendment would function and explores its impact on the dynamics of the settlement process.

The loser-pays rule in England

Under the English rule, "costs follow the event." Generally, in civil non-family litigation, the losing party pays the costs of the prevailing party as taxed, including reasonable attorney fees. This practice, however, has significant limitations and qualifications.

First, costs are not awarded where the losing party's representation is financed through legal aid. Parties whose incomes fall below blue-collar or middle-class levels are eligible for such aid, although they may be required to make some contribution as their means permit.[4] Control is exercised over the acceptance of cases to screen out complaints with no reasonable chance of success.

Second, the loser-pays rule is circumscribed by the way in which costs are awarded. On the entry of final judgment, or of an interlocutory order such as an injunction, the prevailing party applies for taxation of costs attributable to that event. Costs, therefore, are awarded not only at the end of the litigation but also at intermediate stages and may be awarded to a party that does not prevail in the end. Costs, which include both solicitors' and barristers' fees, are considered to be a reasonable amount in respect of all costs reasonably incurred, with any doubts the taxing officer may have resolved in favor of the paying party. The taxing officer, who functions somewhat like a federal magistrate judge, determines fees with reference to a fee schedule, taking into account the time spent, a reasonable hourly rate (which is less than that actually charged by attorneys), and a multiplier based on the amount at stake, the complexity of the matter, and the degree of skill required. Awards tend to run at 60-70 percent of actual fees.[5]

As long as civil cases are tried before juries, fee shifting must be approached with caution.

Costs are taxed against parties, not the attorneys, except in a case of misconduct, which does not include maintaining an unsuccessful action. Taxing masters have wide discretion, but the losing party's financial situation is generally not regarded as relevant. Losing a lawsuit can therefore have severe financial consequences. Even if a party is unable to pay a cost order, the order remains on the books as a continuing liability.

Loser-pays in the U.S.

How would the English rule work in the United States? In the absence of comparable legal aid, access to the courts by economically disadvantaged people would be burdened. Although contingent fee arrangements would still be available, unsuccessful plaintiffs would be exposed to the risk of losing their assets to pay the defendant's fees. (The English rule does not tax costs against attorneys and, presumably, any American version would not do so either.) But the rule's potentially harsh impact would not be limited to those on the lowest rungs of the economic ladder. Even individuals with annual incomes in the $50,000 to $75,000 range would face difficult decisions whether to hazard having to pay an opponent's fees that might equal or exceed their annual income. This risk falls equally on plaintiffs and defendants. An individual or small business confronted with an uninsured claim, for example, might settle rather than assert a reasonable defense and risk having to pay the plaintiff's fees if the defense is unsuccessful. The rule would deter some litigation, but it would do so more on the basis of a litigant's risk averseness than the merits of the litigant's case.

Why, then, does the loser-pays rule survive in England? Apart from tradition and legal aid, one explanation lies in the profound differences between the British and American civil justice systems. England virtually abolished juries in civil cases (except for libel and malicious prosecution) more than 50 years ago.[6] Cases are tried before judges whose decisions are narrowly bound by precedent, not only on liability but on damages as well. Outcomes, therefore, tend to be more predictable in England than in the United States.

As a result, litigation decisions in the two systems are fundamentally different. A case that might to some appear frivolous or marginal upon filing in an American court may still lead to a plaintiff's verdict; similarly, an apparently weak defense may prevail before a jury. As long as civil cases are tried before juries, fee shifting must be approached with caution, lest it result in

4. Published reports indicate that the proportion of people eligible for aid has decreased in recent years from about 70 percent to about 40 percent. *See A Survey of the Legal Profession*, THE ECONOMIST, July 18-24, 1992, at 15-17.

5. *Id.*

6. Administration of Justice (Miscellaneous Provisions) Act, 1933 (restricting the right to trial by jury in civil cases to defamation and other limited exceptions).

imposition of possibly devastating penalties against actions or defenses that could have been winners.

Moreover, lack of predictability in American law is not limited to juries. Substantive and procedural law has undergone constant and sometimes dramatic change during the past 40 years. Law in America is more volatile and less precedent-bound than in England. Propositions that might at one time have been thought frivolous, or at least highly speculative, have become accepted. It is a rare case of which one can say with assurance that it cannot prevail.

If, then, there are circumstances that tend to lead to what many regard as an excess of litigation, they probably reflect the nature of our system more than the litigiousness of the population. It does not seem wise to try to cure problems inherent in our legal system by exposing parties who use it to severe and uncontrollable hazards.

At least two additional reasons exist for rejecting the conventional loser-pays rule: it mistakenly equates "loser" with "party against whom judgment is entered," and it fails to account equitably for the costs that the "winner" may impose on the "loser."

To illustrate this point, suppose the plaintiff in a personal injury action recovers a judgment of $30,000, after incurring attorney fees of $10,000. Under the loser-pays rule, the defendant would have to pay the plaintiff $40,000. But suppose further that the defendant had offered to settle the case for $35,000, and thereafter had to pay substantial attorney fees to defend the case at trial. Had the plaintiff accepted the defendant's offer, the matter would have cost the defendant only $35,000. But by virtue of the loser-pays rule, the defendant—who was the real "winner" in the sense that the judgment was less than what he or she had offered to pay—incurred a loss of more than $40,000 ($30,000 to pay the verdict and $10,000 for the plaintiff's reasonable attorney fees, plus the defendant's own fees).

Or suppose the plaintiff had recovered a judgment of only $500 after rejecting the defendant's $35,000 offer. It makes no economic sense to regard the plaintiff as the winner in this situation and require the defendant to pay the fees, which would probably vastly exceed the amount of the judgment.

These cases illustrate the need for a fee-shifting process to determine the true winner and consider the true costs imposed on the winner by the loser's actions, without generating windfalls or inflicting draconian consequences. An offer-of-judgment rule, appropriately designed, can accomplish these purposes.

The payment-into-court rule in England

The English payment-into-court rule permits a defendant (or cross- or counter-defendant) to deposit in court a sum it believes is sufficient to meet the claim. If the claimant does not accept the deposit, continues through trial to judgment, and recovers less than the amount deposited, it is the losing party. It will not be entitled to costs and will have costs taxed against it from the time for acceptance of the deposit. If, on the other hand, the claimant recovers a judgment for a greater amount, it will be the prevailing party and as such recover costs under the loser-pays rule. The procedure does not preclude a party from recovering costs in connection with an interlocutory proceeding. The deposit may be made at any time, even during the course of trial, though the later it is made, the less its potential benefit. A deposit that has not been accepted within 21 days lapses, but it may be renewed in the same or a different amount.

The procedure creates a strong incentive to early settlement. It provides defendants with the opportunity to reduce the risk of having to pay the plaintiff's costs as well as their own. And it gives plaintiffs the option to accept an offer, eliminating the risk of losing the lawsuit and having to pay both sides' costs. It is a more flexible procedure than the loser-pays rule, because both sides have some control over their fate, beyond the decision whether to file and whether to defend. Decisions about making and accepting offers occur in the course of the litigation when both sides have acquired information enabling them to evaluate their prospects and risks. Moreover, the practice enables parties to avoid proceedings for the taxation of post-offer costs.

An offer-of-judgment rule for the federal courts

Rule 68 of the Federal Rules of Civil Procedure resembles the English practice, except that by its terms it is limited to court costs, generally only a fraction of attorney fees. As now written, it permits a defendant at any time more than 10 days before trial to serve an offer of judgment for money or other relief and costs then accrued. If the plaintiff accepts the offer within 10 days, judgment is entered. If the plaintiff does not accept and the final judgment "is not more favorable [to the plaintiff] than the offer," it must pay the costs incurred after the making of the offer. If an offer is not accepted, a subsequent offer may be made.

Because Rule 68 ordinarily applies only to court costs,[7] it is rarely used. Moreover, it is limited to offers by defendants; plaintiffs do not have the option to make cost-shifting offers. And it invites uncertainty and disputes in the determination of whether a non-monetary judgment is "more favorable than the offer."

Rule 68 could be made into an effective and fair vehicle to encourage early settlements without generating objectionable consequences by adoption of the revision here proposed. The full text of the proposed revision appears on page 151. It has the following elements:

- Recoverable costs include reasonable attorney fees as well as court costs incurred following expiration of the time for acceptance of the offer;
- Offers of judgment may be made by plaintiffs as well as defendants;
- Recoverable costs are limited to the amount of the judgment;
- Recoverable costs are limited to what is needed to make the offeror whole. That is, they would be reduced by the amount by which the offeror benefits from paying or receiving the judgment compared with what it would have paid or received under its offer;
- The period for acceptance of the offer is extended to 21 days, or such additional time as the court may allow, to allow reasonable time for evaluation;
- The court has discretion to reduce costs where necessary to avoid inflic-

7. See text at note 11, *infra*.

tion of undue hardship on a party;

- Claims arising under fee-shifting statutes and class and derivative actions are excluded.

How it would work

The following discussion describes the operation of the revised rule in various typical circumstances. Suppose a defendant offers to settle for $25,000, but the plaintiff rejects the offer and obtains judgment for $20,000. The defendant's reasonable post-offer costs are $10,000. The defendant would be entitled to recover its post-offer costs because the plaintiff's judgment was not more favorable to the plaintiff than the defendant's offer. Had the plaintiff accepted the settlement offer, not only would its recovery have been greater, but both the defendant's and plaintiff's post-offer costs would have been avoided. The proposed rule would reward the defendant for having made a settlement offer the plaintiff could have accepted to its benefit.

Note, however, that the defendant is $5,000 better off under the $20,000 judgment than had the $25,000 offer been accepted. Here the make-whole restriction comes into play. Under the proposed revision, the offeree pays costs "only to the extent necessary to make the offeror whole" and "in no case shall an award . . . exceed the amount of the judgment obtained."

To make the offeror whole, the amount by which the offeror is better off after trial than had the offer been accepted—$5,000—is deducted from the defendant's costs of $10,000. The defendant is therefore entitled to recover only $5,000 of its $10,000 in post-offer costs, and this amount is set off against the plaintiff's $20,000 judgment, making the defendant's net liability to the plaintiff $15,000.

Suppose the defendant's post-offer costs had been $30,000. Under the second limitation mentioned above—the amount of the judgment—the defendant could not recover more than $20,000, the amount of the plaintiff's judgment. This restriction serves to protect plaintiffs against out-of-pocket liability to defendants and to deter offering parties from incurring excessive litigation costs. Both sides' incentives to make offers that are likely to lead to settlement remain substantial, however; plaintiffs because they may lose the benefit of their judgments and defendants because they risk doubling their exposure in case of an adverse judgment.

The risks and opportunities created by the rule should exert constant pressure on parties to move toward agreement.

Now suppose the plaintiff, rather than the defendant, had made a $25,000 offer. Since the judgment of $20,000 was not more favorable to the plaintiff than the offer made, the plaintiff would not be entitled to post-offer costs. The revised rule provides equal incentives for plaintiffs and defendants to make reasonable offers—that is, offers that appear to have a reasonable chance of being more favorable to the offeree than the judgment it is likely to obtain and thereby shifting post-offer costs. As each side moves toward such offers, the negotiating gap between the parties should narrow.

Suppose the plaintiff had offered to settle for $15,000 instead of $25,000. Since the judgment was for $20,000, the plaintiff's offer "beat" the judgment by $5,000 (in other words, the judgment was "more favorable to the offeree") and the plaintiff is entitled to post-offer costs. But the plaintiff's costs will be reduced, just as in the defendant's case, by the amount gained from the rejection of the offer, $5,000. If the plaintiff's reasonable post-offer costs were $10,000, this amount would be reduced by $5,000 and the balance added to the judgment, making it $25,000. The plaintiff's recoverable costs could in no event, however, exceed $20,000, the amount of the judgment.

Confronted with the risk of having to pay all or part of their opponents' fees, litigants are likely to consider offers more seriously. And each is likely to want to hedge its bets by making counter-offers. Thus, the negotiating process will tend to be energized by the rule's incentives. These incentives, moreover, encourage early offers, because the more fees that remain to be incurred, the greater the potential gains and risks. To enable parties to evaluate offers, the time for acceptance is extended to 21 days, with the court having discretion to extend it further. No restriction is imposed on how early an offer can be made. This will create a strong incentive, in cases where the outcome appears relatively certain from the outset, to make early offers to avoid most litigation costs.

The revised rule's incentive structure is based on the imposition of risks on the parties, but the make-whole and capping restrictions limit these risks. No costs are recoverable when judgment is for the defendant. And neither side can expect to recover disproportionate attorney fees and costs.[8]

Multiple offers

The revised rule is designed to accommodate multiple offers. Suppose a defendant rejects the plaintiff's offer to settle for $25,000. Following discovery, the defendant offers $30,000. Meanwhile the plaintiff has incurred $10,000 in costs since making the offer. The case goes to trial, and judgment is for the plaintiff for $27,500. The defendant may have calculated that by making a last-minute offer the plaintiff could probably not beat at trial, it could deprive the plaintiff of the cost-shifting benefits of the earlier

8. In some cases in which the plaintiff has a contingent fee contract with its attorney, the rule could operate to reduce the amount available to pay attorney's fees if the plaintiff recovers judgment but fails to improve on the defendant's offer, and the defendant's post-offer fees absorb much of that judgment. But this disadvantage should be offset by the tendency of the rule to encourage earlier and more attractive settlement offers by defendants.

offer. To promote the ongoing exchange of realistic offers throughout the pretrial period, while preventing game playing that might defeat this purpose, the revised rule provides that a party making an offer "shall not be deprived of the benefits thereof by a subsequent offer unless and until the offeror fails to accept [a more] favorable offer." In other words, if a later offer from the opponent is not more favorable to the offeror than the judgment, taking into account costs incurred in the interim, the earlier offer prevails. But if the opponent's later offer is more favorable to the offeror than the judgment, that offer prevails.

Under the facts stated above, suppose the plaintiff incurred costs of $10,000 after its offer until the time of the defendant's offer. This amount would be deducted from the defendant's offer of $30,000 for purposes of determining whether that offer was more favorable to the plaintiff than the $27,500 judgment. So adjusted, the defendant's offer becomes a $20,000 offer and is not more favorable to the plaintiff than the $27,500 judgment. The defendant has not succeeded in "cutting off" the plaintiff's earlier offer, and the plaintiff recovers its reasonable post-offer costs minus the make-whole reduction of $2,500.

The revised rule's incentive structure remains dynamic throughout the litigation. An offeror is likely to be faced with a counter-offer that will require evaluation. The risks and opportunities created by the rule, amplified by the passage of time and the accumulation of costs, should exert constant pressure on parties to move toward agreement.

Other variables

Improving one's offer. Suppose that sometime after having its offer of $25,000 rejected, the plaintiff offers to settle for only $15,000. Meanwhile it has incurred additional costs of $5,000. The defendant again rejects the offer, causing the plaintiff to incur an additional $10,000 in costs. The judgment is for $30,000. Both the first and second offer are more favorable to the offeree than the judgment, but each has different consequences. Recall that under the revision, an offeror is entitled to the benefit of its offer unless and until it declines to accept a subsequent more favorable offer. Since no subsequent offer was made to the plaintiff, it is still entitled to the benefits of the first offer if they are greater than those of the second. In other words, in the absence of a counter-offer, the plaintiff can choose the offer that will lead to the greater recovery. In this case, the plaintiff can recover $10,000 in costs under the first offer but nothing under the second because of the impact of the make-whole restriction.[9]

Non-monetary offers. When the of-

9. The plaintiff incurred costs of $15,000 following the first offer. But $5,000—the amount by which the judgment exceeded the offer—must be deducted from this amount. Thus, under the first offer, the plaintiff can recover $10,000 in costs in addition to the judgment. Following the second offer, the plaintiff incurred only $10,000 in costs. Since it received a $15,000 benefit, the amount by which the $30,000 judgment exceeded the offer, the plaintiff would not be entitled to recover costs under the second offer.

The proposed revision of Rule 68 of the Federal Rules of Civil Procedure

(a) At any time, ~~more than 10 days before a trial begins, a~~ *any* party ~~defending against a claim~~ may serve upon ~~the~~ *an* adverse party ~~an~~ *a written* offer to allow judgment to be ~~taken against the defending party~~ entered for the money or property or to the effect specified in the offer, with costs then accrued. If within ~~10~~ *21* days after service of the offer, *or such additional time as the court may allow,* the adverse party serves written notice that the offer is accepted, either party may then file the offer and notice of acceptance together with proof of service thereof and thereupon the clerk, *or the court if so required,* shall enter judgment. An offer not accepted shall be deemed withdrawn and evidence thereof is not admissible except in a proceeding to determine costs *and reasonable attorney fees.* If the judgment finally obtained ~~by the offeree~~ is not more favorable *to the offeree* than the offer, the offeree must pay the costs *and reasonable attorney fees* incurred after the ~~making of~~ *expiration of the time for accepting the offer, but only to the extent necessary to make the offeror whole for costs and reasonable attorney fees incurred as a consequence of the rejection of the offer, and in no case shall an award of costs and attorney fees exceed the amount of the judgment obtained. A court may reduce an award of costs and attorney fees to avoid the imposition of undue hardship on a party.* The fact that an offer is made but not accepted does not preclude a subsequent offer. When the liability of one party to another has been determined by verdict or order or judgment, but the amount or extent of the liability remains to be determined by further proceedings, ~~the party adjudged liable~~ *any party* may make an offer of judgment, which shall have the same effect as an offer made before trial ~~if it is served within a reasonable time not less than 10 days prior to the commencement of hearings to determine the amount or extent of liability~~, *except that a court may shorten the period of time an offeree may have to accept an offer, but in no case to less than 10 days.*

(b) An offeror shall not be deprived of the benefits of an offer by a subsequent offer, unless and until the offeror fails to accept an offer more favorable than the judgment obtained.

(c) If the judgment obtained includes non-monetary relief, a determination that it is more favorable to the offeree than was the offer shall be made only when the terms of the offer included all such non-monetary relief.

(d) This rule shall not apply to class or derivative actions under Rules 23, 23.1 and 23.2, or to claims brought under statutes with fee-shifting mechanisms.

fer and judgment include non-monetary relief, the proposed revision calls for a straightforward comparison: "if the judgment obtained includes non-monetary relief, a determination that it is more favorable to the offeree than was the offer shall not be made except when the terms of the offer included *all* such non-monetary relief" (emphasis added). Suppose the defendant offered $25,000 and no additional non-monetary terms. If the judgment is for $20,000 but also includes injunctive relief, the defendant would not be entitled to costs despite its more favorable monetary offer.

Suppose the defendant offered $25,000 and an agreement not to publish material for five years, but the judgment was for $20,000 and an order imposing a trust with all publication profits for three years going to the plaintiff. Because the offer did not include all the non-monetary relief awarded in the judgment, though its monetary terms were more favorable, the defendant is still not entitled to costs. This would be true even if a comparative appraisal were to establish that the terms of the offer had been more favorable than the judgment obtained. The terms must be the same (or subsumed therein) for the offer to be considered more favorable than the judgment obtained. This restriction is necessary to avoid collateral litigation over the evaluation of non-monetary relief.

If, in the above case, the judgment had been for $20,000 and an order not to publish the material for three years, the terms of the offer would have included all the non-monetary relief awarded by the judgment, and the defendant would have been entitled to recover costs. The three-year ban can be said to have been completely subsumed under the offer of a five-year ban (even if the words differed). Note, however, that since the award of fees cannot exceed the amount of money awarded in a judgment, an award of only non-monetary relief precludes fee shifting under the revised rule.

Impact of the proposed revision

As the foregoing discussion has shown, the proposed revision has none of the objectionable features of the 1983 and 1984 proposals:

- It does not threaten plaintiffs with out-of-pocket loss;
- It does not undercut the policy of fee-shifting statutes;
- It does not permit windfall recoveries;
- It does not permit recovery of disproportionate costs;
- It eliminates the need for judicial review of the reasonableness of offers and rejections.

The revised rule eliminates the need for judicial review of the reasonableness of offers and rejections.

Scope of the rule. The revised rule has three exclusions. First, claims arising under fee-shifting statutes, such as the civil rights and antitrust laws, are excluded to avoid undercutting the congressional policy encouraging private enforcement.[10] The effect of this exclusion would be to supersede the Supreme Court's 1985 decision in *Marek v. Chesny.*[11] *Chesny* held that Rule 68 could bar an award of statutory attorney fees to a prevailing civil rights plaintiff who had rejected a settlement offer that exceeded the judgment. The decision did not shift the defendant's fees; the plaintiff remained the prevailing party for purposes of the civil rights statute.

The revised rule also excludes class and derivative actions because Rules 23, 23.1, and 23.2 require settlements of such actions to be approved by the court. To permit unapproved offers of settlement to be operative to shift fees would be prejudicial to the parties and create an irreconcilable conflict with these rules.

The revised rule does not exclude actions in which the parties by prior agreement have provided for recovery of attorney fees by the prevailing party. In such cases, in which a final judgment may include attorney fees, the rule will treat offers as including that component of monetary relief as well as others. Similarly, punitive damages would be treated as an element of monetary relief encompassed in an offer. Doing so is consistent with the normal practice of settling such cases.

Judicial impact. Because of the limits the revised rule imposes on cost recoveries, there is no need for judicial review of rejected offers. But because the revised rule also limits recovery to reasonable attorney fees, the court is the ultimate arbiter of the award. If the rule operates as contemplated, however, the court should rarely have to be called on, because the vast majority of cases will settle, and because it is reasonable to expect that more often than not, the rule's make-whole and capping limits will make it self-evident that reasonable attorney fees exceed the amount allowable, obviating the need for court proceedings. If the revised rule accomplishes its purpose of generating not only more but earlier settlements, and with less need for judicial intervention than currently, the resulting savings in judicial time should more than offset the amount of time required by the occasional attorney fees proceedings under the rule.

Impact on settlements

The assumption underlying the proposed revision is that it will encourage parties to make earlier and more reasonable offers, leading to earlier settlement negotiations with greater prospects of success.

The legal literature abounds with economic analysis of fee-shifting mechanisms. Not surprisingly, given the complexity of the subject, opinions differ on whether such mechanisms encourage early settlement. One writer recently concluded that

10. Pendent state law claims would be included.
11. 473 U.S. 1 (1985).

"[u]ntil a better empirical foundation has been established, the existing theoretical arsenal is still too weak to resolve many of the ultimate questions of interest."[12] "Institutional details" motivating and constraining the behavior of parties and lawyers, the writer noted, are not necessarily accounted for by the current economic analysis of fee shifting.

Indeed, a host of not readily quantifiable factors can influence the incentive structure in any particular case. Deep-pocket litigants determined to eliminate their adversaries or those driven by principle or policy might be impervious to economic incentives. Highly risk-averse litigants, on the other hand, would be extremely sensitive to the threat of added costs and opt for settlement.

Some commentators have argued with respect to a loser-pays rule that it might actually discourage settlement rates by driving apart litigants who both firmly believe they will win. According to this argument, in such a case only the prospect of the parties bearing their own attorney fees creates a range of possible settlements. If, instead, each party believed that the other side would ultimately bear all the costs of the litigation, the incentive to settle to avoid expenses would disappear. For example, under the American rule, if the plaintiff firmly believed he or she would recover $10,000, and the defendant firmly believed there would be no recovery, but each anticipated having to spend $6,000 to take the case through trial, the parties might enter settlement discussions anyway, because even a $5,000 settlement would leave each party in better financial shape than a trial. Yet under the loser-pays rule, the argument goes, the litigants might dig in since each anticipates no net loss following a verdict.

Even if this argument has some validity under a loser-pays rule, it carries little weight under the proposed offer-of-judgment rule. For the defendant, there is no advantage in digging in without ever making an offer, as there might be under a loser-pays scheme, for by digging in it gives up any chance of recovering costs, regardless of any recovery by the plaintiff. For the plaintiff, in turn, there is no advantage in refusing to make an offer that might beat the judgment. And once such an offer is on the table, the defendant's risk of loss escalates unless it accepts the offer or makes a counter-offer attractive to the plaintiff. Unlike the loser-pays scenario under which the parties may be stalemated, the revised rule provides incentives that should energize the negotiating process.

The incentive structure under the revised rule will not be equally powerful in all cases. In large and especially multiparty litigation—in which the stakes are high relative to costs and control may be dispersed—fee-shifting offers of judgment may have little utility. But as the cost of litigating a dispute rises in relation to its value, the power of the revised rule increases. Because the incentive will be to confront the opponent with an offer it would not lightly refuse, offers and counter-offers should move toward the middle ground.

It is true that the larger the gap between an offer and a judgment, the larger will be the offeror's make-whole offset against the costs he or she can recover to reflect the resulting benefit. Thus, if a defendant offering to settle for $35,000 succeeds in holding the plaintiff to a $5,000 judgment, the defendant will recover less in costs than if the plaintiff won a judgment of $30,000. Similarly, the larger the excess of a judgment over a plaintiff's offer, the greater the offset against a plaintiff's cost recovery. This result is a necessary corollary of the make-whole principle underlying the rule. But it does not significantly weaken the revised rule's incentives and is justifiable on the basis of the benefit derived by the offeror from the more favorable result obtained.

The principal impact of the revised rule will likely be on cases in which the cost of litigation could become disproportionate to the amount at stake. It would also have a significant impact in cases where liability is all but certain. Suppose a creditor is owed $50,000. He or she estimates that to take the case through trial will cost approximately $50,000. The defendant may currently be able to escape having to pay the debt by simply stonewalling, figuring that the creditor may not wish to throw good money after bad. The revised rule would enable the creditor to file suit and make an offer of judgment for $49,999. If the debtor refuses the offer, it risks having to pay the debt as well as the creditor's and its own costs. The creditor can go to trial and incur costs up to $50,000 without jeopardizing any of the $50,000 recovery. The debtor, facing up to $100,000 in potential losses, plus its own attorney fees, has a strong incentive to settle. Similarly, a defendant with a strong defense against a doubtful claim can make a modest offer, with a high expectation of setting off its costs against a judgment if the offer is rejected.

No doubt, even under the proposed revised Rule 68, some litigation will continue to be protracted and costly. Some cases will not, and should not, settle for any number of reasons. But the revised rule may often give parties the push that is needed to initiate settlement negotiations on a basis that is likely to lead to agreement. □

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12. Donohue, *The Effects of Fee Shifting on the Settlement Rate: Theoretical Observations on Costs, Conflicts, and Contingency Fees*, 54 LAW & CONTEMP. PROB. 195 (1991). There have also been several analyses focusing on the question of including legal fees under Rule 68. See Rowe, *American Law Institute Study on 'Paths to a Better Way': Litigation, Alternatives and Accommodation—Background Paper*, 1989 DUKE L. J. 824; Rowe and Vidmar, *Empirical Research on Offers of Settlement; A Preliminary Report*, 51 LAW & CONTEMP. PROB. 13 (1988); Miller, *An Economic Analysis of Rule 68*, 15 J. OF LEGAL STUD. 93 (1986); Toran, *Settlement, Sanctions and Attorney Fees: Comparing English Payment into Court and Proposed Rule 68*, 35 AM. U. L. REV. 301 (1986); Woods, *For Every Weapon a Counterweapon: The Revival of Rule 68*, 14 FORD. URB. LAW J. 283 (1986); Simon, *The Riddle of Rule 68*, 54 GEO. WASH. L. REV. 1 (1985).